BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket No. 92-266
Protection and Competition	)	
Act of 1992	)	
	)	
Rate Regulation	)	

PETITION FOR RECONSIDERATION OF NEWHOUSE BROADCASTING CORPORATION

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SUMMARY

The FCC's rules implementing the rate regulation provisions of the 1992 Cable Act unnecessarily and unfairly penalize "good actors" -- companies such as Newhouse that have maintained a low rate structure and have not taken advantage of their deregulated status. For example, the Commission's rules prohibit cable operators with rates that fall below the permitted benchmarks from adjusting their rates to reasonable benchmark levels. Aside from being unjustifiably forced to maintain rates below a "reasonable" level, these "good actor" systems are likely to be hindered in their ability to finance technological improvements which would benefit their subscribers. Such a result plainly warrants reconsideration of this issue.

Newhouse also points out that, in passing the 1992 Cable Act, Congress sought to ensure the availability of a reasonably priced basic service tier. At the same time, Congress created a separate framework to examine cable programming service rates on a case-by-case basis and to reduce those rates only where they were clearly excessive. Yet, the FCC ignored this dual approach and adopted a tier-neutral regulatory scheme, harming both subscribers and cable operators. As applied to "good actor" systems, tier neutral regulation will cause an increase in the cost of basic service. This is clearly not what Congress intended. Moreover, the FCC's tier neutral regulatory scheme will drive up a system's copyright costs -- costs that the

Commission has indicated may be recovered only on a delayed basis at best.

Newhouse is concerned primarily with those portions of the FCC's rate regulation decision adversely impacting "good actors" and their subscribers; however, there are additional aspects to the new rules which also merit reconsideration. For example, under the FCC's rules, all equipment that passes signals on the regulated basic service tier is subjected to "actual cost"

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Pursuant to Section 1.429 of the Commission's rules, Newhouse Broadcasting Corporation ("Newhouse"), by its attorneys, hereby petitions for reconsideration of the Commission's Report and Order ("Order") in the above-captioned proceeding.[1] Newhouse actively participated in the rulemaking proceeding leading to the adoption of the Order, filing both comments and reply comments in response to the Commission's notice of proposed rulemaking.

DISCUSSION

I. THE COMMISSION'S RATE REGULATION SCHEME CONTAINS ELEMENTS THAT UNNECESSARILY AND UNFAIRLY PENALIZE THE CABLE INDUSTRY'S "GOOD ACTORS"

The principal focus of this petition is Newhouse's concern over the impact of certain elements of the Commission's rate

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[1] Report and Order in MM Docket No. 92-266, 58 Fed. Reg. 29553 (1993).

Commission has indicated may be recovered only on a delayed basis, at best.

These issues are discussed fully in the sections that follow. In addition, the practical impact of these decisions is set forth using a real-world example involving one of Newhouse's systems. Based on the discussion presented herein, Newhouse submits that the Commission must revisit its decision with an eye toward better protecting the "good actor" cable system and its subscribers.

A. Cable Systems With Below Benchmark Rates Should Be Permitted To Raise Their Rates To Reasonable Benchmark Levels.

The Commission has punished "good actors" by prohibiting cable operators with rates that fall below the permitted benchmark at the time of regulation from adjusting rates toward or up to the limit, without a cost showing to justify such an increase.[3] In reaching this decision, the Commission has implicitly assumed that operators charging below benchmark rates are making reasonable profits.[4] Newhouse contends that whether or not this is true misses the point. Rather, the Commission's focus should be on the overriding statutory mandate of "ensuring

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[3] Order at ¶ 232.

[4] Specifically, the Commission theorizes that "it is reasonable to assume in most cases that, whatever the rate an operator not subject to effective competition is charging for basic service, such a rate is not unreasonably low from that operator's perspective. Indeed, the rate level was voluntarily selected by the operator." Order at ¶ 232.

that the rates for the basic service tier are reasonable."[5] Because benchmark rates are presumed reasonable, there is no logical justification for precluding an operator currently below the benchmark from charging the benchmark rate.

Ironically, capping below benchmark rates does not just penalize those who have been "good actors"; it also rewards those operators who already are at or above the benchmark. For example, the cap impairs the ability of below-benchmark systems from updating their systems to the benefit of subscribers. At the same time, systems with rates exceeding the benchmark will be required to reduce their rates either to the benchmark or by 10%, whichever is less. Even with such reductions, above-benchmark systems will be entitled to charge a rate greater than those systems with below-benchmark rates.[6]

The unfairness of this restriction is further compounded when one considers that the annual adjustment index -- which

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[5]47 U.S.C. § 543(b)(1) (emphasis added).

[6]For example, Newhouse operates the cable system serving the southern portion of Prince George's County, Maryland. Newhouse estimates that this system -- which charges $21.45 for expanded basis service -- will be at or perhaps only slightly above the Commission's benchmark. The cable system serving the northern portion of the county is charging $4.50 more for comparable service. Yet, under the Commission's rules, the Newhouse system will be capped at its present rate (or may suffer a slight reduction), while the higher-priced neighboring system probably will face only a 10 percent reduction -- leaving it with higher rates and greater financial resources than the Newhouse system. It is neither logical nor fair for the Commission to preclude two similarly situated systems from charging the same rate and, indeed, for the lower-priced system to find its rates capped below those of a higher-priced system.

permits an operator to raise basic service tier rates to take into account yearly increases in the cost of doing business -- is tied directly to an operator's initial capped benchmark rate.[7]

subject to the same per-channel benchmark.[11] Newhouse submits that this approach, which will punish the "good actors" rather than those cable operators who abused their prior deregulated status, disregards both the plain language of the 1992 Cable Act and the intent of Congress and, thus, should be reconsidered.

More specifically, under the Act, the basic service tier is subject to a generally applicable, locally-administered regulatory scheme designed to ensure the availability to cable subscribers of at least a "lifeline" level of service (i.e., local broadcast signals, non-superstation distant signals, and PEG channels) at reasonable rates; in contrast, non-basic service is governed by a federally-administered, complaint-driven "bad actor" approach aimed only at eliminating unreasonable rates charged by a small minority of operators. Furthermore, the differences in the statutory provisions relating to basic and non-basic rates are not limited to matters of procedure and forum. Sections 623(b) and (c) contain separate and, in several respects, substantively distinct, sets of factors for the FCC to use in developing rules for evaluating basic and non-basic rates.

For example, with respect to basic rates, the statutory

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[11] "The permitted charge per channel, prior to adjustments for inflation and external cost, will be the same for all tiers. In addition, the benchmark formula is based on prices that are averaged across all tiers. Per channel charges calculated in this way and compared to a benchmark that is based on tier-

criteria relate either to the costs of providing or to the revenues derived from services provided on the basic tier.[12] Moreover, even with respect to joint and common costs of providing cable service generally, the Commission is directed to consider only such portion of those costs as is reasonably and properly allocable to the basic service tier in deriving a formula for the regulation of basic rates.[13]

On the other hand, with respect to cable programming services, the Commission is directed to look beyond the costs of providing such services and to consider the history of rates for cable programming services and the rates, as a whole, for all cable programming, equipment, and services offered on the system other than premium services.[14] Furthermore, the Commission is directed to consider not just the rates for cable systems subject to effective competition, but also the rates for similarly situated cable systems that are not subject to effective competition but which offer comparable programming.[15]

Despite the clear evidence that Congress intended separate regulatory standards for basic and non-basic rates, the Commission has adopted a unitary, tier neutral regulatory approach. The Commission has computed benchmarks based solely on

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[12]47 U.S.C. §543(b)(2)(C)(ii),(iv),(vi).

[13]Id. at §543(b)(2)(C)(iii),(v).

[14]Id. at §543(c)(2)(A),(C),(D).

[15]Id. at §543(c)(2)(A),(B).

the rates charged by operators subject to effective competition, completely disregarding Congress' instructions to consider systems not subject to effective competition in adopting regulations applicable to non-basic rates. In addition, the FCC's unitary scheme averages all tier costs into average per channel rates. This, of course, is contrary to the Act's plain language requiring the FCC to exclude non-basic tier costs in the

Congress' intent to single out the "renegades" and the "minority of cable operators" who have abused their deregulated status.[18]

More importantly, the Commission's approach is directly at odds with the goal of ensuring the availability of a relatively low-priced basic tier of service. Good actors such as Newhouse have attempted to ensure widespread access to cable service by maintaining a low-priced basic tier. Rather than reward or even protect such operators, the Commission's unitary approach will force basic rate increases -- some quite dramatic in scope -- as operators seek to avoid overall reductions in revenue far beyond the ten percent level claimed by the Commission.[19]

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[18]The concept that Congress did not intend for rates for non-basic services to be subject to the same pervasive regulatory structure as basic service is evident from the legislative history of the 1992 Cable Act. For example, while introducing H.R. 4850, Representative Markey (D-MA) stated: "In addition to [basic rate regulation] the bill includes provisions to rein in the renegades of the cable industry by requiring the FCC, on a per case basis, to regulate unreasonable rates charged for service." 138 Cong. Rec. E1033 (April 10, 1992); see also H.R. Rep. No. 628, 102d Cong., 2d Sess. 86 (1992) (emphasis added):

> The Committee recognizes that since cable rates were deregulated in 1986, there has been an increase in the quality and diversity of cable programming. While most operators have been responsible about rate increases in this deregulated environment, a minority of cable operators have abused their deregulated status and have unreasonably raised subscribers rates.

[19]The Commission has attempted to justify its decision to implement a tier neutral approach by stating that it wants to discourage retiering. Order at ¶ 171. There is, however, no basis for taking such a position. In fact, after establishing a minimum content requirement for the basic tier, Congress left additional tier decisions as to the basic tier solely within the discretion of the cable operator. 47 U.S.C. §543(b)(7)(A).

(continued...)

In sum, Newhouse urges the Commission to reconsider its decision to adopt a tier neutral regulatory scheme. A careful examination of the 1992 Cable Act's plain language, and a review of its legislative history, demonstrates that Congress intended that basic and non-basic rates be afforded very different treatment. Because the Commission's approach is contrary to Congressional intent, and will result in the imposition of higher rates on many basic-only subscribers, this decision must be reversed.[20]

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[19](...continued)
Moreover, as the Commission itself recognized with regard to evasions, retiering does not violate the Act and is in fact required in many cases. Order at ¶ 453. Thus, the Commission has no authority to create a tier neutral regulatory scheme which is contrary to statutory language in order to meet an objective wholly of its own creation.

[20]If the Commission rejects the arguments made in this section and affirms the use of a tier neutral system, Newhouse urges the Commission to mitigate the harsh results by providing cable operators flexibility within the benchmark. Newhouse suggests that if an operator's overall rate is at or below the benchmark - and the basic tier rate is at or below the benchmark - an operator should be permitted to offer a below benchmark basic rate and a somewhat higher non-basic rate, provided the total still does not exceed the benchmark. This alternative is entirely consistent with the 1992 Cable Act. Specifically, the statute requires the Commission to examine "the rates, as a whole, for all the cable programming, cable equipment, and cable services provided by the system" (other than premium services) in determining the reasonableness of an operator's non-basic rate in individual cases. 47 U.S.C. §543(c)(2)(D) (emphasis added). Thus, with respect to non-basic rates, the Commission is not required to establish separate benchmarks of reasonableness as it is required to do with basic service and equipment, but only a single benchmark to determine whether operator's overall rates are reasonable for the level of service provided.

C. Cable Operators Should Be Permitted Immediate Recovery Of Increases In Cable Compulsory License Costs.

The Commission has indicated that cable operators may pass through to subscribers increases in certain external costs, albeit not until sometime next year. Included among these recoverable external costs are costs associated with obtaining programming. Obviously, these costs include the fees cable operators pay to cable program networks and retransmission consent fees. Moreover, in its published "Question and Answers" relating to cable television rate regulation, as well as in the Order itself, the Commission has indicated that cable compulsory license royalty payments also represent ar recoverable programming cost.

Newhouse agrees that cable compulsory license royalty payments should be treated as an external cost which an operator may pass through to subscribers. However, while the Commission has indicated that rates may not be increased to account for increased external costs until sometime next year, Newhouse submits that there are compelling reasons for allowing operators to begin passing through increased compulsory license costs immediately.

First, unlike other programming costs, the compulsory license rate and the schedule for paying royalties are not negotiable -- they are fixed by law. Thus, an operator has far less ability to control the amount of these costs, and the timing

of their occurrence, than is the case with respect to the fees charged by cable programming networks.

Even more significantly, some cable operators will face substantially higher copyright fees, beginning this year, as a direct consequence of the Commission's rate regulation scheme. As described above, the Commission's tier-neutral rate regulation approach will force cable operators to abandon low-priced "lifeline" tiers of basic service. One of the side benefits of these low-priced tiers has been to hold down an operator's copyright costs. As the price for basic cable service increases under the Commission's regulatory scheme, many operators will be forced to pay greatly increased copyright costs.[21] Newhouse requests that the Commission permit cable operators to pass through such increases in copyright costs as those increases are incurred.

D. The Practical Effect Of The Above-Described Actions Is to Punish "Good Actors" And Their Subscribers.

The three previous sections have described several aspects of the Commission's decision that unfairly penalize "good actor"

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[21]For example, prior to the 1992 Cable Act some cable operators may have been Form Two (Form SA2) copyright filers due to the low revenues attributable to basic service. The cable operator thereby paid a flat royalty fee without regard into the number of distant signals carried. The Commission's rules may cause cable operators who were Form Two copyright filers to become Form Three (Form SA3) copyright filers and thereby greatly increase copyright costs in the first year. The Copyright Office requires the operator to pay these costs but the FCC's current rules do not allow the operator to recover the costs as they are incurred.

cable systems. To more fully illustrate the problem, Newhouse has analyzed the impact of the new rules on its Pinellas County, Florida system. The following description should help the Commission focus on the unfortunate consequences its action will have if it is not modified.

The Pinellas County system currently provides broadcast basic service consisting of 19 channels (including superstations) at no monthly charge. It offers a second tier of 29 cable satellite channels for $16.95 per month. Its last rate increase was in May, 1992 (an increase scheduled for May, 1993 was cancelled due to the Commission's freeze order). The system estimates that its permitted rate per channel (including equipment) will be <u>well below</u> the Commission's benchmark and its rate for expanded service is less that of neighboring systems.

As consequence of the Commission's rules, this system will be required to impose a charge of approximately $7.50 per month for basic service and, as a result, will incur an increase in copyright royalty payments of approximately $650,000.00 per year. This will negatively impact both the subscribers to the basic tier (typically low income and elderly residents) who will now face a significant charge for this level of service and the cable system, which will incur a huge increase in its costs.

Further, the system will have been prevented from increasing its rates for over 24 months (assuming 6 months from the end of the freeze period will be its earliest permitted adjustment date)

and will be held to a smaller annual charge than comparable systems due to its low initial permitted rate. If this system had "rushed" to increase its rates upon passage of the 1992 Cable Act, it could have maintained any increases up to the benchmark. By not increasing its rates prior to its normal adjustment date, the system now finds itself restrained from receiving an increase

other aspects of the new rules that should be reconsidered as well. Two of these concerns -- the Commissions flawed treatment of equipment installed for the purpose of providing subscribers access to per-channel and/or per-program services and the creation of unnecessary obstacles to the calculation and use of system-wide maximum permitted rates -- are addressed below.

A. Equipment Provided For Per-Channel Service Should Be Unregulated.

Newhouse requests that the Commission clarify that the regulatory status of equipment leased to non-basic subscribers depends on whether the equipment is provided for the purpose of delivering per-channel services. Under the Commission's rules, all equipment used to receive the regulated basic service tier is subjected to "actual cost" regulation, "regardless of whether such equipment is additionally used" for unregulated per channel service.[22] Newhouse finds that the Commission's approach is overly broad and unnecessarily regulates the provision of per-channel services. In particular, equipment installed so that a non-basic subscriber can have access to per-channel services should be unregulated, even if that equipment also happens to pass signals in the basic service tier.

The 1992 Cable Act provides for the regulation of rates for equipment used to receive basic service and refrains from the

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[22]Order at ¶283; 47 C.F.R. §76.923(a).

regulation of per-channel service.[23] On the one hand, the Act seeks to ensure that equipment rates for basic subscribers are reasonable, which is consistent with the mandate for a reasonable basic service package, i.e., service plus equipment.[24] In contrast, the 1992 Cable Act does not require the regulation of rates for equipment used to receive per-channel services,[25] which is consistent with the general exemption from rate regulation of per-channel services.[26]

Section 623(b)(3)(A) of the 1992 Cable Act specifically limits actual-cost regulation of basic equipment to two classes: (1) equipment "used by subscribers to receive the basic service tier," and (2) equipment required for a basic-only subscriber to receive programming on a per-channel or per program basis pursuant to the anti-buy through provision.[27] If Congress intended all equipment to be subject to actual cost pricing, the 1992 Cable Act would not have specified that rates applicable to descrambling equipment in the anti buy-through context are subject to actual cost regulation. Rather, Congress must have

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[23]47 U.S.C. § 543(b)(3); cf. 1992 47 U.S.C. § 543(l)(2).

[24]47 U.S.C. §543(b)(1).

[25]The single exception to this is the anti-buy through provision, to be discussed below.

[26]See 47 U.S.C. § 543(l)(2) (definition of "cable programming service" excludes "video programming carried on a per channel or per program basis").

[27]47 U.S.C. § 543(b)(3)(A) (emphasis added); 47 U.S.C. §543(b)(8).

intended that equipment required for non-basic subscribers to access per-channel services, e.g. an addressable box, would be unregulated, even if this more advanced equipment also tunes the basic tier signals.[28] The fact that signals from all service categories -- basic, cable programming, and per-channel -- pass through a single addressable box is merely a convenience for the subscriber as it avoids the need to provide an A/B switch or, indeed, even a second set-top converter.

The technical distinctions between equipment used to receive basic service and equipment used to receive per-channel service support the foregoing legal analysis. The signals of the basic tier are typically unscrambled, which avoids the need for any terminal equipment. In these cases, a relatively inexpensive converter box may be provided to some basic subscribers in order to tune basic tier signals which extend beyond the tuning range

technology and signal security features which go beyond the simple tuner extension function of basic converters. Because of the more sophisticated equipment, addressable boxes are more expensive than converter boxes and the cable operator will

[redacted]

B. Cable Operators Should Be Entitled To Compute Their Maximum Permitted Rate On A System-Wide Basis.

Newhouse requests that the Commission modify or clarify several statements in the Order and the Worksheet instructions that appear to impose unnecessary burdens on cable operators in complying with the rate regulation provisions of the Act. Specifically, Newhouse urges the Commission to: (1) disregard differences in franchise fees in establishing when an operator may use system-wide data in calculating its maximum initial permitted rate; (2) eliminate the requirement that the local franchising authority give its prior consent to the use of a system-wide worksheet approach; and (3) allow advertising of service and equipment rates exclusive of government-imposed external costs.

Calculating maximum permitted rates using system-wide data to complete the worksheets provides a means of reducing administrative costs without any appreciable unfairness to subscribers.[31] These cost savings are realized from the reduction in paperwork, storage costs, and the costs of

preparation of separate worksheet statements that would be necessary under a community-by-community approach.

The worksheet instructions indicate that system-wide calculations are permitted where rates and channel line-ups are identical throughout a system.[32] However, the Commission has created a major impediment to the use of this cost saving device by requiring that franchise fees must be uniform within all communities in order for a cable operator to calculate rates on a system-wide basis.[33] This makes no sense. Franchise fees are external to the rate calculation. In fact, Worksheet 1 specifically excludes both bundled and unbundled franchise fees from the rate determination.[34] Therefore, if a system's rates (exclusive of franchise fees) are constant throughout the communities served, there is no reason to restrict the use of system-wide computations.

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[32]Footnote One of the instructions for FCC Form 393 reads: "When completing this form, except where noted, you should use data from the community unit involved. However, you may use data for the system instead of the community unit if all relevant factors (including program service and equipment rates, channel line-ups and franchise fees) are identical and the local franchising authority permits you to use such system data."

[33]See Footnote One of the instructions for FCC Form 393.

[34]In addition, franchise fees are to be external costs in the price-capped rate increases and benchmark calculations. Order at ¶254 ("These costs are largely beyond the control of the cable operator, and should be passed on to subscribers without a cost-of-service showing."); see also, Order at ¶256 ("We note, however, that the competitive benchmark formula and survey data will not include franchise fees.").

Similarly, requiring prior franchising authority approval of system-wide rate treatment for systems that have identical rate characteristics serves no public interest function and is likely to increase administrative burdens. There simply is no logical reason to allow local officials to force the production of community-specific worksheet computations where the operator is offering the same channel line-up and charging the same service and equipment rates in all of the communities it serves. As noted above, the Commission is under a statutory duty to minimize the administrative burdens associated with the rate regulation process. Eliminating the requirement of prior franchising authority approval for system-wide rate calculations presents the Commission with a perfect opportunity to carry out that statutory duty.[35]

Finally, Newhouse requests that the Commission reconsider its decision that cable operators "may not quote a rate for cable service in advertisements and other promotional materials that does not include costs itemized pursuant to Section 622(c)."[36]

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